

THE COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

United States Department of the Treasury



NEW MARKETS TAX CREDIT PROGRAM: THIRD ROUND (2005) ALLOCATEES

On May 11, 2005, the Community Development Financial Institutions Fund (Fund) announced that 41 community development entities (CDEs) had been selected to receive allocations of New Markets Tax Credits (NMTCs) under the 2005 round of the NMTC Program. These 41 CDEs are authorized to issue to their investors a combined total of \$2 billion in equity for which NMTCs can be claimed.

Throughout the life of the NMTC Program, the Fund is authorized to allocate to CDEs the authority to issue to their investors up to the aggregate amount of \$15 billion in equity as to which NMTCs can be claimed. This is the third allocation round. In three rounds to date, the Fund has made 170 awards totaling \$8 billion in tax credit authority.

How does the program work?

The \$15 billion NMTC Program is expected to stimulate economic and community development and job creation in the nation's low-income communities by attracting capital from the private sector.

The NMTC Program provides tax credits to investors who make "qualified equity investments" in privately managed investment vehicles called CDEs. Codes are required to invest the proceeds of the qualified equity investments in low-income communities. Low-income communities are generally defined as those census tracts with poverty rates of greater than 20 percent and/or median family incomes that are less than or equal to 80 percent of the area median family income.

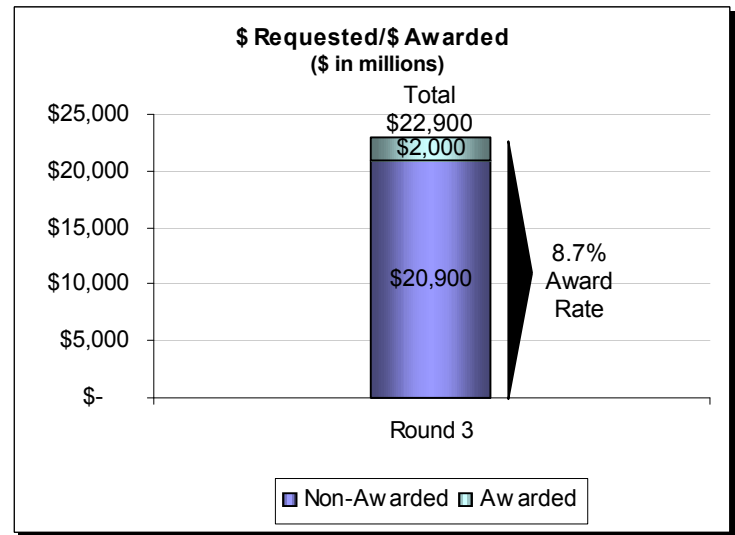
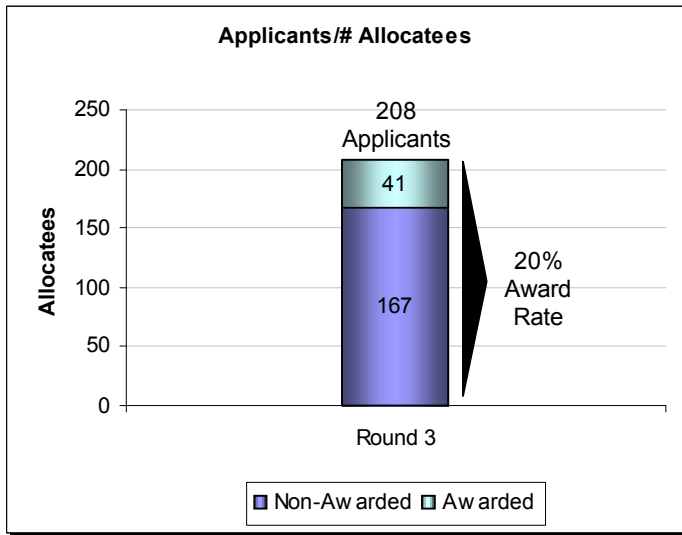
The credit provided to the investor totals 39 percent of the investment in a CDE and is claimed over a seven-year credit allowance period. In each of the first three years, the investor receives a credit equal to five percent of the total amount paid for the stock or capital interest at the time of purchase. For the final four years, the value of the credit is six percent annually. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period.

What was the distribution of allocations in the 2005 round?

- 208 CDEs applied for allocations, requesting a total of \$22.9 billion in allocations.
- 41 CDEs (or 20% of the total applicant pool) received \$2 billion of allocation authority.
- The average allocation award is approximately \$48,780,000 per allocatee.
- Allocation awards range in size from \$5 million to \$100 million. The median allocation award amount is \$50 million.

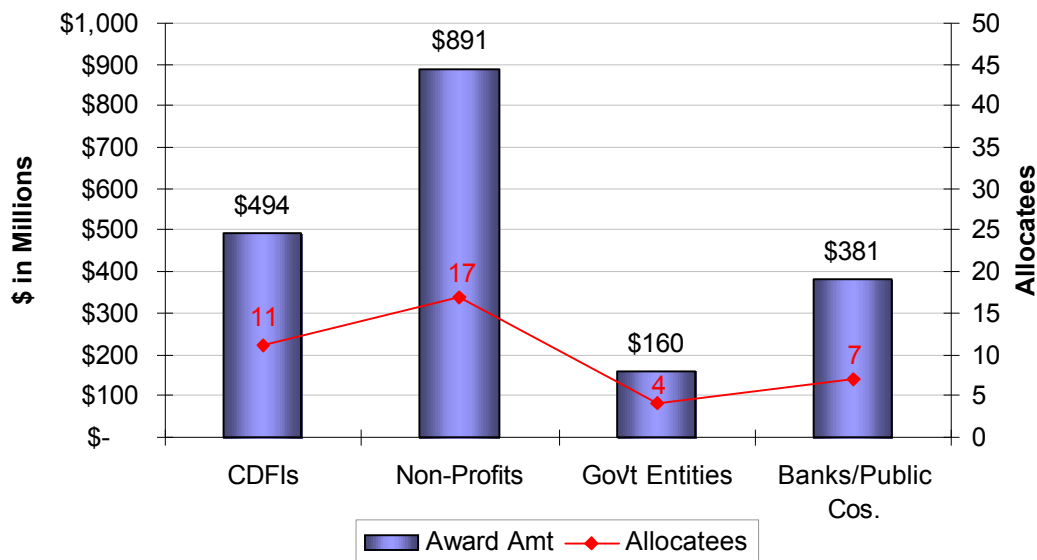
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What were some of the characteristics of the 41 allocates?

- Seventeen of the allocates (or 41%) are non-profit organizations or subsidiaries of non-profit organizations. They received allocations totaling \$891 million.



- Eleven of the allocates (or 27%) are certified CDFIs or subsidiaries of certified CDFIs. They received allocations totaling \$494 million.

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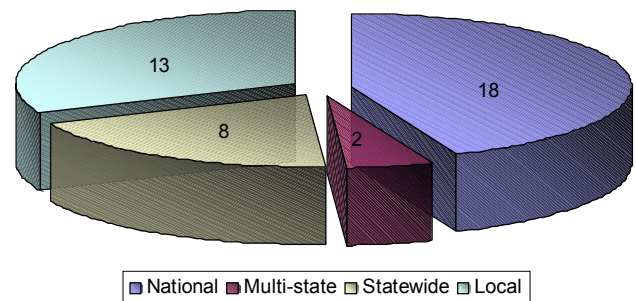


- Seven of the allocatees (or 17%) are non-CDFI banks or bank holding companies; publicly traded institutions; or subsidiaries of such entities. They received allocations totaling \$381 million.
- Four of the allocatees (or 10%) are governmentally controlled entities. They received allocations totaling \$160 million.
- In all, 22 of the allocatees (or 54%) are CDFIs, non-profit organizations, governmentally controlled entities, or subsidiaries of such organizations. They received allocations totaling \$1.04 billion.

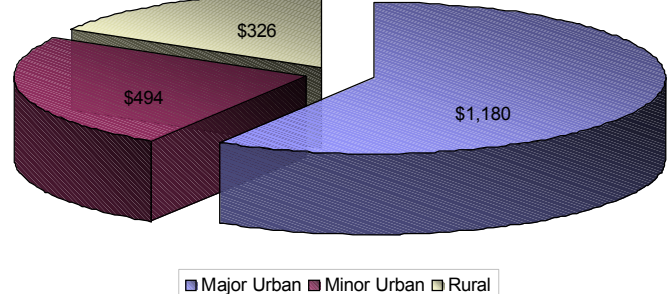
Where will the investments be made?

- The 41 allocatees are headquartered in 20 different states and the District of Columbia, but anticipate making investments in at least 33 different states, as well as D.C.
- Twenty of the allocatees (or 48%) will focus investment activities on a national or multi-state service area; eight of the allocatees (or 20%) will focus activities on a statewide service area; and thirteen of the allocatees (or 32%) will focus on local markets (e.g., a citywide or countywide area).
- Based upon information reported by the allocatees, it is anticipated that approximately \$1.18 billion (or 59%) will be invested in major urban areas; approximately \$494 million (or 25%) will be invested in minor urban areas; and approximately \$326 million (or 16%) will be invested in rural areas.
- While all allocatees are required to invest substantially all (generally 85%) of the qualified equity investments they receive in low-income communities, most applicants committed to invest NMTC proceeds in areas characterized by more severe economic distress (i.e., areas that have significantly higher poverty rates and lower median family incomes than those minimally required under the NMTC Program; areas that have unemployment rates at least 1.5

**Mkt Served
By Allocatee**



**Investment Area
(\$ in millions)**



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times the national average; and/or areas that have been designated for economic development through other governmental programs such as Brownfields, Empowerment Zones and Renewal Communities). Of the 41 allocatees, 37 indicated that at least 75% of their activities will be provided in these areas of more severe economic distress, and 21 indicated that 100% of their activities will be provided in such areas. The Fund will require these allocatees, through their allocation agreements, to meet the benchmarks identified in their applications.

What types of eligible investment activities do allocatees plan to make?

- NMTC proceeds may be used to finance a wide variety of activities, including:
 - Loans to or equity investments in businesses. ***Approximately \$494 million (25%) of NMTC proceeds will likely be used to finance and support loans to or investments in businesses in low-income communities.*** Allocatees have proposed strategies ranging from microenterprise lending to multi-million dollar venture capital investments.
 - Loans to or equity investments in real estate projects. ***Approximately \$1.18 billion (59%) of NMTC proceeds will likely be used to finance and support real estate projects in low-income communities.*** Most real estate projects, with the general exception of projects consisting mainly of residential rental housing, are permissible under program regulations. Allocatees have indicated that they intend to make investments in commercial, retail, industrial, mixed-use and homeownership projects, as well as in community facilities such as daycare centers, healthcare centers, and charter schools.
 - Capitalization of other CDEs. ***Approximately \$326 million (16%) of NMTC proceeds will likely be used to provide capitalization for other CDEs.*** Allocatees may make direct loans to or investments in other CDEs to finance NMTC-eligible activities, or may purchase NMTC-eligible loans originated by other CDEs. This will help ensure continued availability of capital in low-income communities.
- All 41 of the allocatees indicated that at least 75% of their loans and investments will have flexible or non-traditional features, and 36 of the 41 allocatees indicated that 100% of their loans and investments will have flexible or non-traditional features. Such features include, among other things: equity and equity-equivalent terms and conditions; subordinated debt; below market interest rates; and reduced origination fees. The Fund will require these allocatees, through their allocation agreements, to meet the benchmarks identified in their applications.
- All 41 of the allocatees indicated that they would invest more than the minimally required 85% of QEI dollars into qualified low-income community investments, and 36 of the 41 allocatees indicated that at least 95% of their QEI dollars would be invested into qualified low-income community investments. In real dollars, this means at least \$200 million above and beyond what is minimally required under the NMTC program will be invested in low-income communities. The Fund will require these allocatees, through their allocation agreements, to meet the benchmarks identified in their applications.

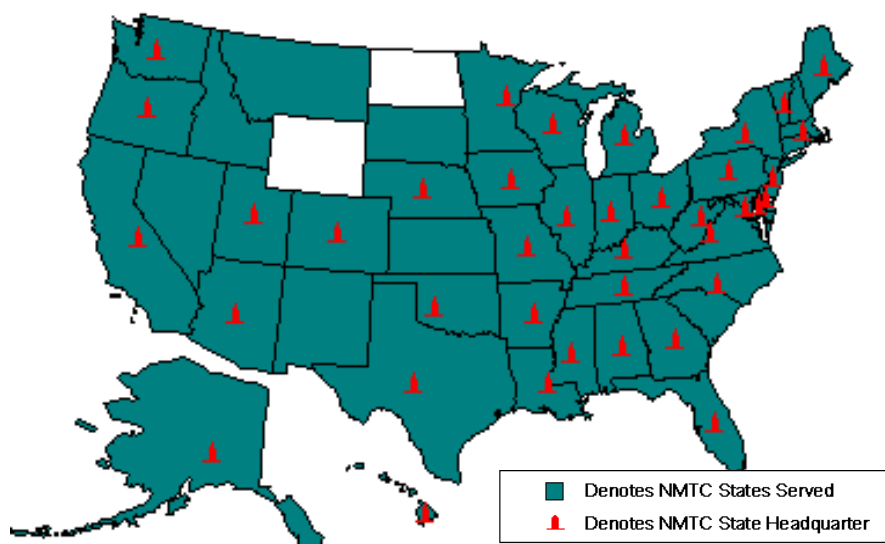
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What is the geographic coverage of the NMTC Program?

The NMTC Program, through just three allocation rounds, has achieved near national coverage. To date, 170 NMTC awards totaling \$8 billion of tax credit authority have been made to 156 different



CDEs. Allocatees are headquartered in 38 states and the District of Columbia. They have indicated primary service areas that cover 48 states and the District of Columbia. Only two states, North Dakota and Wyoming, have not been specifically identified as part of an allocatee's primary service area. But an allocatee serving a national market could potentially make investments in these states, as evidenced by the fact that a first round allocatee headquartered in New York City used NMTCs to finance the renovation of a 6,500 square foot, historic fire station in Casper, Wyoming. This building had been vacant for 30 years, and will now be converted to commercial use.

Have the allocatees from the first and second allocation rounds begun raising investor dollars?

Over \$2.16 billion in qualifying equity investments have been made into CDEs since the program's inception. This represents over one-third of the \$6 billion in allocation authority issued to CDEs to date – a remarkable start given the newness of the program. In addition, while allocatees are by statute allowed up to five years to raise investor dollars, each of the allocatees have committed to make a substantial portion of their investments within 3 years.

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How have the allocatees from the first round been investing these dollars?

The Fund requires reports from CDEs. Reports covering transaction-level data are due to the Fund, along with audited financial statements, 180 days after the end of each allocatee's fiscal year – which in most cases is December 31st. Because first round allocatees did not enter into allocation agreements with the Fund until late in 2003, very few allocatees had transactions to report for 2003. The vast majority of transactions to date occurred in 2004, and will be included in reports that are due to the Fund on June 30, 2005.

Nonetheless, many CDEs have independently notified the Fund of qualified investments they have made with NMTC proceeds, including :

- Investment in an airplane parts manufacturer that allowed it to open a new plant in **rural Oklahoma**, which will create 500 new jobs in a low-income community.
- The development of a high-tech business incubator in inner city **Detroit, Michigan** that will provide new technology training opportunities for community residents and entrepreneurial opportunities for minority and women business owners.
- Redevelopment of a grocery-anchored shopping center in **Akron, Ohio**.
- Project financing for a commercial and cultural center built on the site of an abandoned factory in **San Diego, California**.
- Investment in a sustainable forest project in **rural Maine** that will restore operations to a formerly closed mill, preserving and/or re-activating over 600 jobs.
- Rehabilitation of a 60,000 square foot commercial development, located on a former brownfield site in **Tacoma, Washington** that will house art galleries, a food establishment, and 36 residential lofts.
- Purchase and redevelopment of a church-operated childcare center in **Chicago, Illinois**.
- Investment in a coal mining company in **West Virginia** that allowed it to expand operations to a new mining site, which will create 50 new jobs.

Please explain the NMTC application evaluation process.

The Fund is authorized over a seven-year period to allocate to CDEs the authority to issue up to \$15 billion in equity for which NMTCs may be claimed. In this third round of allocations, the Fund was authorized to allocate to CDEs the authority to issue up to \$2 billion in equity for which NMTCs may be claimed. The Fund received 208 applications that together totaled over \$22.9 billion in NMTC requests.

The review process used to select NMTC allocation recipients is summarized below:

Step One:

- The review process required three reviewers to independently review and evaluate each application. The reviewers included private sector members of the community development finance community, federal agency staff working in other community

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development programs, and Fund staff. Reviewers were selected on factors such as their knowledge of community and economic development finance and experience in business or real estate finance, business counseling, secondary market transactions, or financing of community-based organizations.

- The Fund screened each reviewer to identify any potential conflicts of interest with applicants. The Fund provided each reviewer with detailed descriptions of what constituted a conflict of interest, and each reviewer was required to sign a certification that they had disclosed all conflicts of interest to the Fund. Reviewers were further required to sign a confidentiality agreement stating that they would not reveal any information obtained from the Fund during the review process.
- Once selected, the reviewers underwent training to prepare them for the review process and were provided guidelines to assist them in scoring each application.
- Reviewers rated each of the four evaluation sections (Business Strategy, Capitalization Strategy, Management Capacity and Community Impact) as follows: Weak (0-5 points); Limited (6-10 points); Average (11-15 points); Good (16-20 points); and Excellent (21-25 points).
- In addition, reviewers rated applicants with respect to two statutory priorities: (i) 1-to-5 points for demonstrating a prior record of serving disadvantaged businesses or communities; and (ii) 5 points for committing to invest substantially all of the proceeds from their qualified equity investments into unrelated entities (i.e., entities that are generally not controlled or owned by the allocatee or its investors).
- In addition to evaluating and scoring each application, reviewers were required to recommend an allocation amount, based on information provided in the application. Reviewers were instructed to recommend both two-year and five-year allocation amounts, based on the amount of capital the reviewer determined the applicant could reasonably raise and deploy over these time periods.

Step Two:

- An Allocation Recommendation Panel comprised of Fund staff reviewed the recommendations made by reviewers in Step One.
- In order to be considered for an allocation, an application had to achieve an aggregate base score (without including priority points) that was minimally in the "good" range based on a scoring scale of weak, limited, average, good and excellent. In addition, an applicant had to achieve an aggregate base score minimally in the "good" range in each of the four application evaluation criterion. Thus, an application with scores in the "good" range in three of the four criteria, but an "average" score in the fourth criterion, could not advance to the panel phase of the review process.
- A statistical review was conducted to identify inconsistent scores. In some cases

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where there was an inconsistent first phase reviewer score, the comments and recommendations of a fourth independent reviewer were used to determine whether the inconsistent score should be replaced.

- For each application, panelists reviewed the applicants in the rank order of their scores, and considered the comments and recommended allocation amounts provided by each of the first phase reviewers. Due to the large number of applications that were ranked highly by first phase reviewers, and given the Fund's desire to expedite the flow of capital into low-income communities, panelists were instructed to determine an allocation amount for each qualified applicant that reflected the applicant's needs over a 2-year period (a 2-year allocation amount), as opposed to a 5-year allocation amount. This 2-year allocation amount was then used as the basis for the final award amount. The Fund determined that awarding allocations based upon the 2-year recommended allocation amounts would be the most effective way to ensure a fair distribution of allocations to as many of the most qualified candidates as possible.
- The panel also reviewed a variety of compliance, eligibility, due diligence and regulatory matters. Included in this review were (i) checks to determine whether any applicants that have been awarded funds through other Fund programs were compliant with the award requirements, and disbursement eligibility requirements; (ii) checks to determine whether prior-year allocatees successfully issued the minimum requisite amount of Qualified Equity Investments from prior awards; and (iii) consultation with the IRS with respect to any applicant that proposed a business strategy that may not be permitted under the NMTC Program regulations.
- As stated in the application materials, applicants that were recommended for an award amount that was lower than the minimum acceptable award amount specified by the applicant in Question 42 of the allocation application were not provided with a NMTC allocation.

Step Three:

- After the second stage of the review process, both the rank order list of applicants and the recommended 2-year allocation amounts were forwarded to the Selecting Official (NMTC Program Manager) for an allocation determination.
- In the event the Selecting Official's decision varied substantially from the panel's recommendation, the Reviewing Official (Deputy Director) reviewed the application file and made a final determination, helping to ensure a thorough set of checks and balances.

Step Four:

- The Fund's Awards Management unit checked the GSA's list of debarred organizations to confirm that neither the allocatees nor their parent companies have been debarred from participating in any federal programs.

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What are the next steps in the selection process and for the next allocation round?

- All applicants will be informed via e-mail of the Fund's decision. Shortly thereafter allocatees will enter into allocation agreements with the Fund.
- Applicants that were not selected for an allocation will be able to review specific reviewer comments pertaining to their application through a debriefing document that will be prepared by Fund staff. This document will be distributed in advance of the next allocation round.
- Following an internal evaluation of the NMTC application and selection process the Fund will determine whether any modifications are needed for the application and applicant guidance materials.
- It is expected that the application for the third round of allocations will be available in the summer of 2005, will be due in the fall of 2005, and that allocation decisions will be made in the spring of 2006.
- For the next allocation round, the Fund will be able to issue up to \$3.5 billion in NMTC allocation authority.